Ron Peterson, Avista Corp,
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Factors Affecting Availability & Cost of Capital to IOU's

Current Investor View

- Uncertainty & confusion about the industry
  - California energy crisis / FERC investigations
  - Enron Bankruptcy
  - Trading issues / improprieties
  - Recent near bankruptcies
  - Project cancellations
  - FERC policy direction (transmission, SMD)
  - Uncertainty about our national energy policy
  - Restructuring

- Financial uncertainty
  - State regulatory environment
  - Volatile energy prices
  - Cost recovery/disallowances
  - Regulatory lag – timing of cost recovery & cash flows
  - Liquidity and financial flexibility
  - Counter-party risk
  - Complex financial transactions and hidden liabilities
  - Non-regulated investment performance

Current Credit Status of the Utility Industry

Rapid decline in credit quality	1st half of 2002	1st half of 2001
S&P Downgrades	78	28
S&P Upgrades	6	17
"A" or Better Ratings	43%	56%
BBB ratings	51%	39%
Below Investment Grade	6%	4%

- Funds from operations to total debt is at **17% for the industry** – typical for an average "BB" rating. ("BBB" would normally be 31%)
- Average debt ratio nearly 60% vs. 54% 5 years ago (Avista & Puget both near 60%)
- Rating agencies take negative credit actions much more quickly
- Avista was downgraded to below investment grade last year = BB+
- S&P has stated that regulation can contribute to financial stability and the ability to remain investment grade

Results

- Some investors are leaving the industry
- Banks may no longer provide credit & covenants are much more stringent
  (Two long time banks left the Avista credit line last year)
- Investors staying demand higher risk premiums for capital
- Financing transactions take more time to complete

- Over the past 18 months, more than 60 proposed plants in the NW have been cancelled

Financing Implications
- Complex financial transactions less likely to occur – more debt will show up on balance sheets
- Low forward power prices and credit issues for IPP's and their counter-parties will result in capital constraints and less power plant construction by smaller or weakly capitalized merchants
- Utilities may need to access large amounts of capital to construct generation
- Would be difficult for Avista to finance a large generation plant today (because of debt covenants and market value of stock)

Policy Considerations
- It is important to restore the financial health of regional utilities
- Stated goals about utility credit quality can be reassuring to investors (but actions must match words)
- More certainty about cost recovery will enhance credit quality
- Timely rate actions and cost recovery are critical
- Timely pass-through of commodity costs
- Maintain streamlined approval processes for financing activities
- Regulatory/Legislative actions to allow financing and cost recovery for DSM, renewables, and alternative energy resources (e.g. DSM tariff rider) are a plus
- Should we consider steps to encourage large companies to enter the regional market?